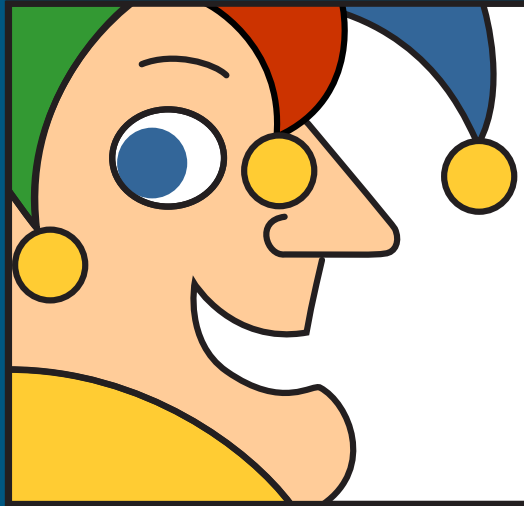


The Motley Fool



TO EDUCATE,
AMUSE & ENRICH



**THE TEN STEPS TO
FINANCIAL FREEDOM**

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Introduction - What is Foolishness?

Welcome to the Motley Fool. You may not realise it yet, but you've just found your ticket to financial independence. The kind of independence that might enable you to retire early, buy that second home on the Costa Blanca (oh all right then, the Bahamas), or fly to New York on Concorde for a long weekend whenever you feel like it.

As a newcomer, you might be wondering just what on earth all this “Motley Fool” stuff is and why you should spend any time here. You were looking for information about money (right?) and now you're staring a court jester directly in the eye. This probably strikes you as a little odd. That's no surprise, but we reckon that everyone talks about money far too earnestly. It's very definitely a serious matter, but people are often more interested in sounding like they know what they're talking about than in actually explaining anything. The court jesters of the past recognised that to understand certain things, you had to strip off an outer layer of pomposity. With this approach, their humour instructed as it amused. In fact, it's been said that these Fools were the only members of the Royal entourage who could tell the truth without having their heads lopped off.

“This is the mission of the Motley Fool – to educate, amuse and enrich.”

This is the mission of the Motley Fool – to educate, amuse and enrich. We want to help you to make smart decisions about your money. Most people have never been taught much about finance and often we

just muddle through as best we can. But tending to your finances isn't as mysterious or complex as you've probably imagined – and we're going to make it even easier for you.

For a start, we think the person who really has your best interests at heart is you. We also think that you don't need any fancy credentials to sort out your finances. All that's required is some common sense: and you've obviously got bundles of that, since you've read this far already.

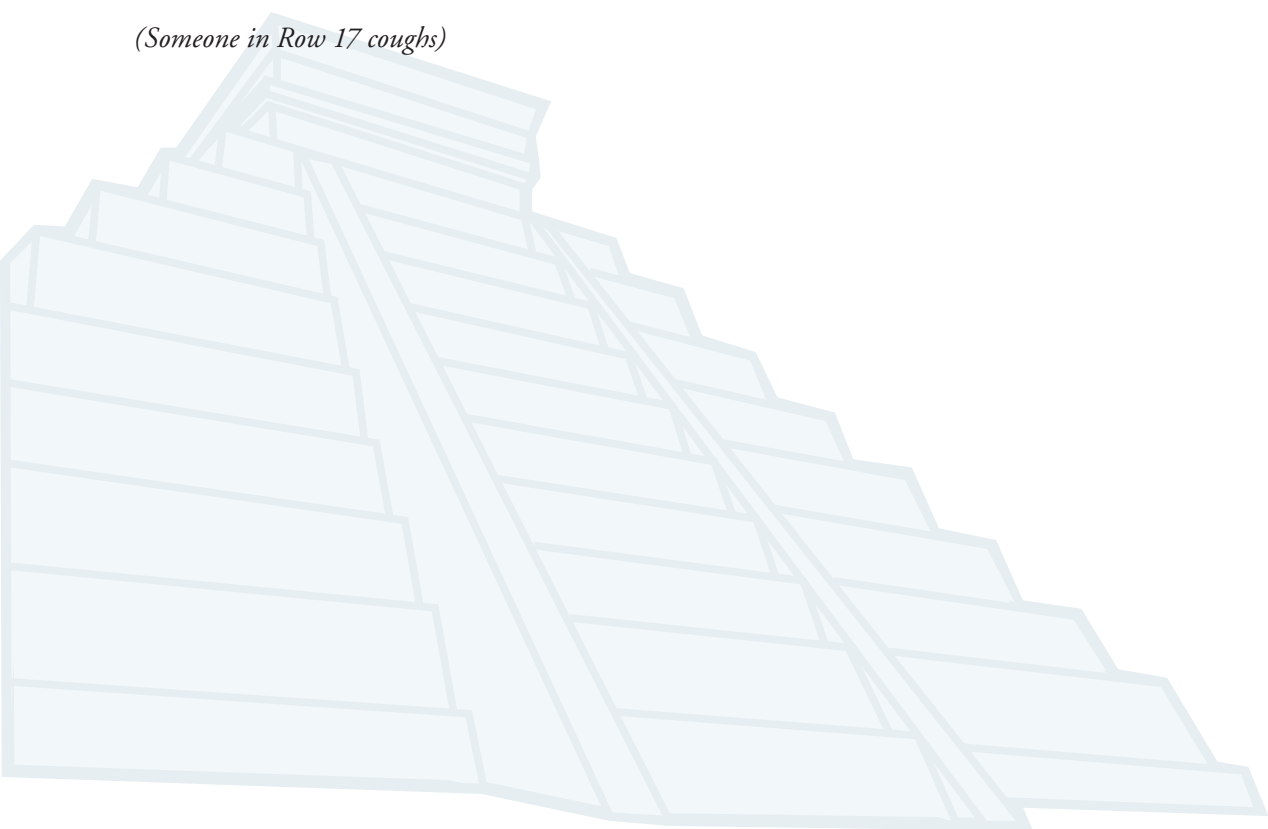
Anyway, without further ado, let's part the curtains and unveil the Foolish approach to saving and investing for your future.

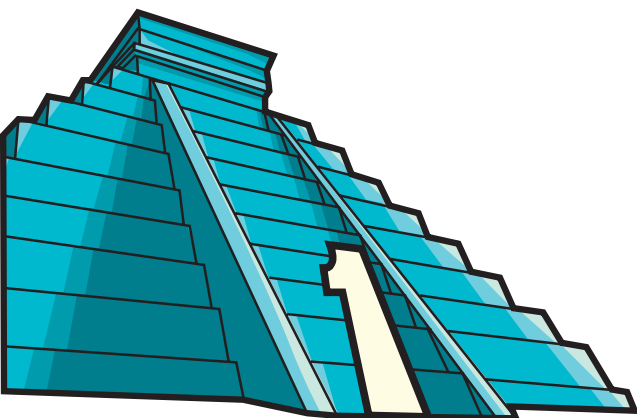
Creak, creak, creak.

(The sound of curtains being drawn open)

(Oooohs and ahhs from the audience)

(Someone in Row 17 coughs)





Step One - The Miracle of Compound Returns

Sorting out your finances is good for you. Understanding how to save for the future helps you to get rich so, in time, if you get a sudden urge to buy that lovely shiny new Ferrari you saw for sale down the road, you can do so. (OK – so it's probably more likely to be a Ford Mondeo than a Ferrari, but the sentiment's the same.)

One of the first steps towards sorting things out is to make sure you take advantage of the Miracle of Compound Returns. Put simply, this means that, if you're saving, the returns should be as high as possible for as long as possible. Here's why:

Over long periods of time a difference of only one or two percentage points can have a huge impact. You don't have to do any maths to understand compounding – it simply means that your money makes more money over long periods of time, particularly if you're getting the highest interest rates possible. So, you start off just getting interest, but then you earn interest on that interest and then you earn interest on the interest on the interest, and so on. You get the picture. Over long time scales, it really adds up. Let's have a look at how this works.

Assume a number of Foolish women at the age of 20. All appreciate the importance of long-term regular investment but disagree about the best method. For the sake of argument we'll assume that they have each

chosen methods that return different annual growth rates and they each contribute £100 per month until they're 60. Let's look at the numbers:

	Fenella 5%	Felicity 8%	Freda 12%	Faith 15%	Florence 20%
Age 20	0	0	0	0	0
Age 30	£15,499	£18,128	£22,404	£26,302	£34,431
Age 40	£40,746	£57,266	£91,986	£132,707	£247,619
Age 50	£81,870	£141,761	£308,097	£563,177	£1,567,625
Age 60	£148,856	£324,180	£979,307	£2,304,667	£9,740,753

As you can see, even small differences in the rate of return have a huge impact on the final pot.

Now let's introduce you to Fay, a Foolish young woman who, on her 20th birthday, sensibly decides to invest £100 a month into an index-tracker ISA (more on these later). For the purposes of our example, let's say it appreciates at a rate of 12% a year – a not unreasonable estimate, although bear in mind that we haven't taken inflation into account. At the age of 30 she marries Ferdinand, stops work to have children and cancels the direct debit into her ISA.

Ferdinand, meanwhile, who has frittered away his money and his twenties on pastimes too terrible to mention here, decides on his 30th birthday to start contributing the same £100 a month into the same scheme and continues until he is 60. The numbers pan out like this:

	Fay £100pm Age 20-30	Ferdinand £100pm Age 30-60
Age 20	0	0
Age 30	£22,404	0
Age 40	£69,582	£22,404
Age 50	£216,112	£91,986
Age 60	£671,210	£308,097

Ouch! Extraordinary, isn't it? Fay only contributed for 10 years and yet she's got more than twice as much as her husband. So it's not just

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the size of the returns that are important – it's how soon you start saving too!

Just think what a difference it could make to your life if your savings work for you in this way. Seeking out the best returns on your money, which generally means keeping the costs as low as possible, could

“And small sums
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pounds a month.”

make literally thousands of pounds worth of difference. Many of the products we buy have high charges, and these charges cut a big chunk out of the money we're trying to save. So, beware! And the sooner you start, the more likely it is that you'll be able to pay off your mortgage early, or retire sooner. And small sums soon build into bigger ones so don't worry if you can only save a few pounds a month. It'll soon grow. The trick is to get sorted and start saving.

So, think about where you keep your money and what you can do to make sure that you are getting the best from it. A good place to start, for example, is with your bank. Almost all of us have a bank account, but we often don't think about whether we could do better elsewhere. So, start by looking at your [bank account](#) to see if it's really doing its best for you: take note of the interest rates printed on your latest statement. And do it now!



Step Two - Dump Those Debts

The Miracle of Compound Returns can be a fantastic thing when you're saving or investing money. Unfortunately it works in reverse when you're borrowing money and it explains why debts often spiral out of control.

Take credit cards, for example. They're very useful things if we have to borrow money but if it's got a high interest rate and you can't afford to pay off much each month, then it's the credit card company that is getting the benefit of compound returns. And we don't want that, do we?

In fact, did you know that the average debt in the UK is £2,500 per person? For most people this borrowing probably has an interest rate of at least 15%. That amounts to £375 per year in interest alone. To some people, £375 may not seem like a lot of money, but think of it this way: if you lost your wallet and it had £375 in it, would you be upset? Of course you would! Apart from anything else it's the price of a week's holiday in one of Europe's cheaper and sunnier climes – but instead we're freely giving it away to SpendULike Finance or BuyNow Plastic! And if we only ever make the minimum payments

“...did you know
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on our credit cards, then the compound returns for the lender just grow bigger and faster.

Another thing we often do is carry debt on our credit card while accumulating savings in the building society. This doesn't make sense because if the savings are only earning, say, 5% but the debts are costing 15%, then we've got a shortfall of 10%. Say you've got £1,000 in the building society and debts of a similar amount. The interest on your savings would only be about £50 per year, while the debt would be costing you £150. It makes no sense at all; far better to use the savings to pay off the debt and start again from scratch so that our savings are earning real returns.

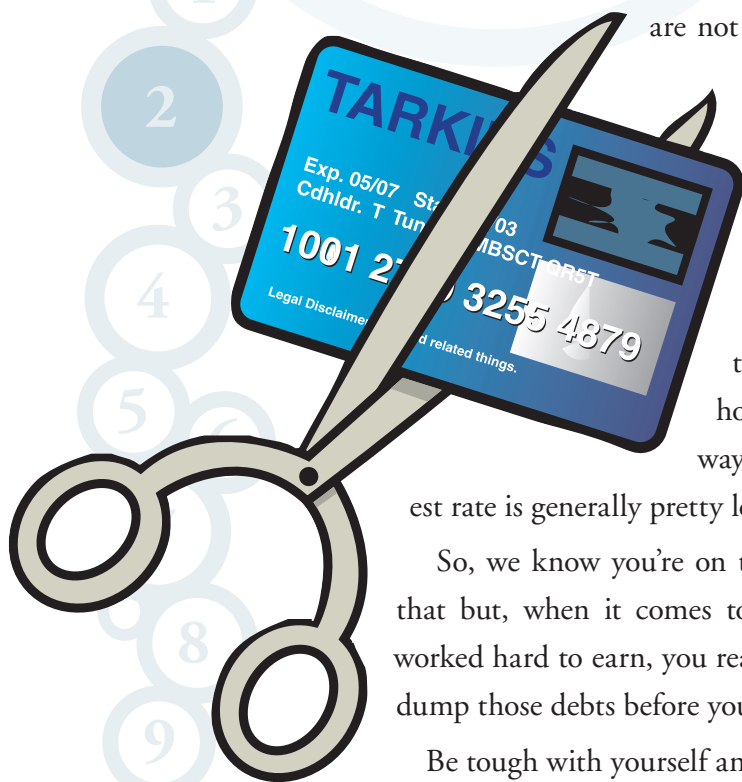
As it happens, the Motley Fool's [debt discussion board](#) is peppered with people looking for help after realising that years of out-of-control spending have resulted in them being thousands of pounds in debt – and that's not counting the mortgage. So if you're in this situation, you

are not alone! Banks and credit card companies are so eager for your business that they'll raise your credit limit without you even having to ask, or they'll offer you special deals like cash-back. Credit is not credit – it is debt! The only time it makes sense to borrow money is when you buy a house, because there's usually no other way of being able to afford it and the inter-

est rate is generally pretty low.

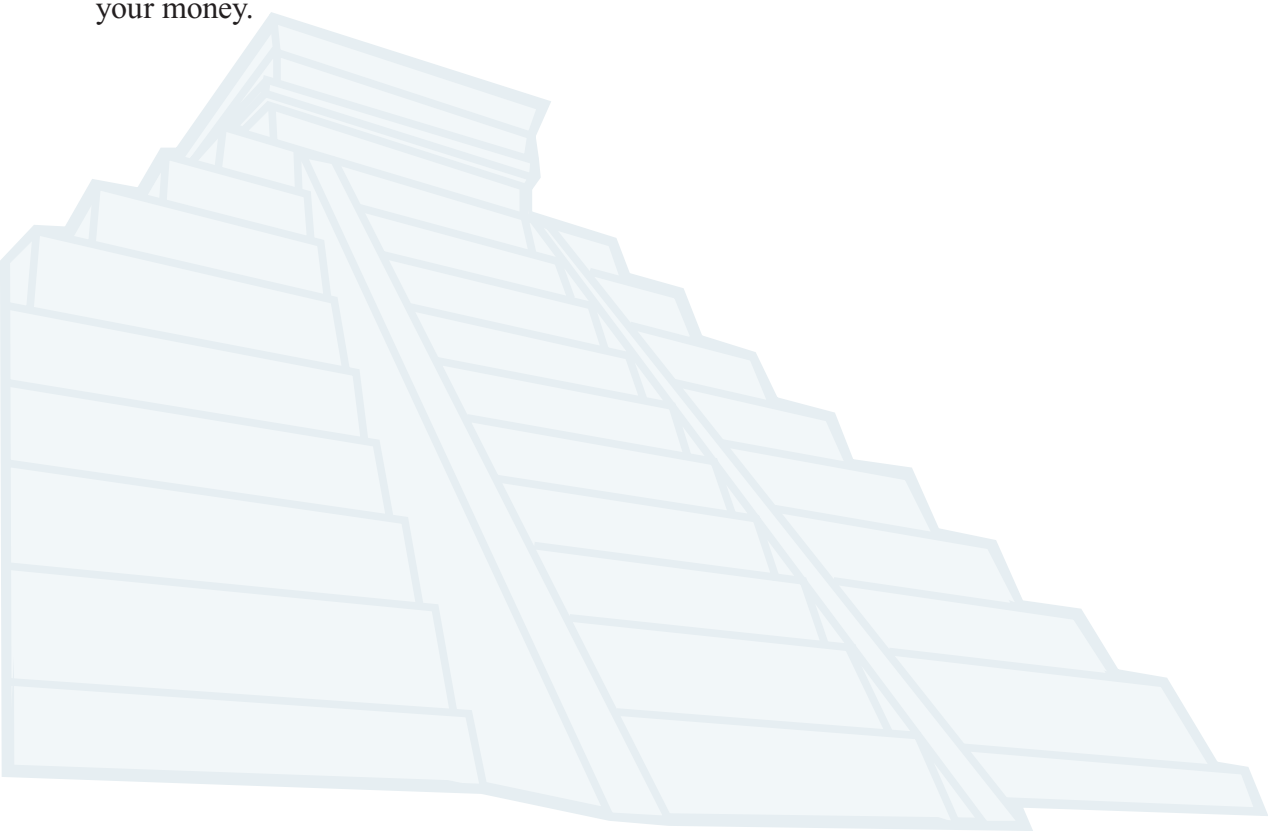
So, we know you're on the information superhighway and all that but, when it comes to saving and investing money you've worked hard to earn, you really need to obey the rules. It's time to dump those debts before you do any form of saving.

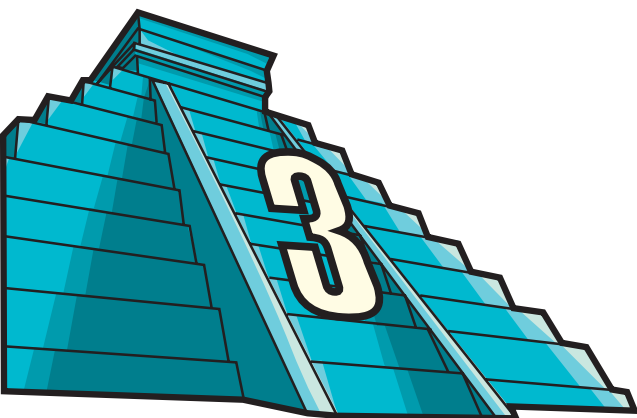
Be tough with yourself and take a good look at your finances.



- How much do you earn, after tax each month?
- What are your outgoings each month?
- What's left?

If the “what's left?” is negative, you're obviously being unrealistic. You are living above your means. So rein in your spending for a while and think about where the money's going. And even if your ‘what's left’ amount is positive, you still may be wasting money somewhere. Remember the more you can save for the future, and the sooner you start, the better off you'll be. The Motley Fool's [Get out of Debt Centre](#) will take you through the process of working out your overall financial position and show you how to get a better deal for your money.





Step Three - Bricks and Mortar

One day you're probably going to want to buy a house. Maybe you've already bought one. Either way it's most likely that it'll involve a mortgage, which is the one debt many of us have to have because we'd never be able to afford to buy our home otherwise. Fortunately, mortgage providers are prepared to lend people money at a reasonable rate, and it is

usually a far cheaper way of borrowing than almost any other form of debt, because it is secured against the value of the property.

“That’s all there
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That’s all there is to a mortgage: it’s a very cheap means of borrowing money to buy a house or flat. The principles are simple. The problems come in paying back this borrowed sum. First of all you have to pay off the interest on the loan each month. There’s no way around that. Then you have to decide how to repay the initial sum you borrowed.

You have a choice. Do you want to pay the loan off gradually during the term of the mortgage (a repayment mortgage), or do you want to invest a little each month somewhere and pay off the sum in full later on when you’ve built up a pot (an interest-only mortgage)? Each one is just a different way of

reaching the same objective.

Follow the repayment path and part of the cash you pay each month will cover interest on the loan, and the rest will pay off a portion of the capital sum you initially borrowed. Gradually, over the course of the mortgage, you will own a greater and greater share of your home. Think of it as buying your property one brick at a time.

Go down the interest-only road and you will have the amount you borrowed outstanding for the whole term and will only pay off the interest each month. At the end of the term you'll need to find a lump sum to pay off the capital and the usual way is to invest in the stock market by drip-feeding monthly payments into a special fund.

Whoa! Did we just say stock market? Don't panic! This is how an interest-only mortgage works and there are good reasons for this. Historic studies show that the stock market has provided a greater return than any other investment over any 20-year period in the past century. (Don't worry, we'll explain more later.) So, with this cash working for you, rather than buying a brick each month, you're hoping to make a big enough pot at the end of the mortgage term to pay off the capital sum.

Admittedly, our first Foolish mantra is that you should always pay off debts before you invest. However, like it or not, that's what you are doing with a mortgage – investing – whether you pay it off early with cash (via a repayment) or later on with returns from shares (using an interest-only loan). You are after all buying an asset – a house – with this loan. As always, you're trying to get the best possible deal, and our [guide to mortgages](#) should help you to do that.

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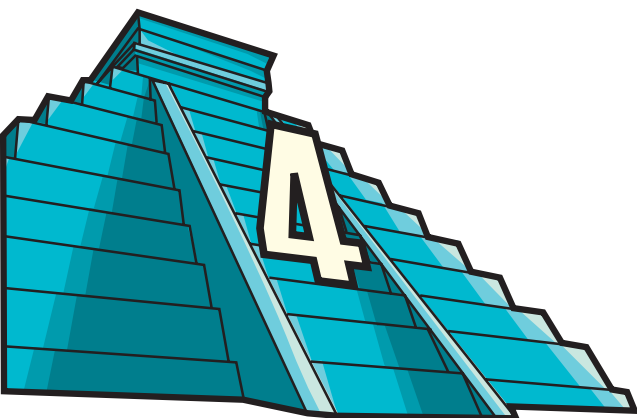
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Step Four - Hurrah - No More Work

Let's face it, few of us want to get old. What we do want, though, is some sort of plan to make sure that, when our pay cheques dry up, we've got a big enough pot of money for us to do the things we want. So, usually we look for some sort of pension plan and pay into it on a monthly basis until it's time for us to retire. Your pension fund manager invests it in the stock market and, on retirement day, hands you the pot of money he's managed to make for you – less his fees and charges, of course.

The trouble is sometimes that pot of money isn't enough to pay for 20 or 30 years of easy living and it's usually because we've thought about things the wrong way round. We tend to think about now rather than then. Not surprising, really, as it's rather hard to see into The Future, but The Future is actually



where we should start so we can then work backwards to the Here and Now.

What we need to ask ourselves are these questions:

1. When are our pay cheques likely to stop?
2. What is it that we want to have and want to do in retirement?
3. What would be enough money for us to achieve this?
4. How are we going to go about getting this pot of money together?

Providing for your retirement means balancing a number of factors, and it's important to see it this way from the start. The earlier you want to retire, the fewer years you have in which to save your pot of money. And, of course, the less time you have in which to save, the more you'll need to put aside each month.

You might say that you should save as much as possible so that you can simply retire when you decide that you have enough. Unfortunately, this makes little sense either. What is saving as much as possible? Should we live on cornflakes and take no holidays until retirement? It might enable you to retire early and with a huge pot of money, but it wouldn't do much for your health and you probably wouldn't know what to do with the money when you did retire. Similarly it would be miserable to retire with a much lower income than you've got used to living on. So, you have to live for the present and save for the future. Putting together a retirement plan is about striking a balance between the two.

The answer is to aim for a retirement that maintains the standard of living that you've got used to during your (and/or your partner's) working life. There is no point in saving extra to give yourself a higher standard of living in retirement since, apart from anything else, you may not make it that far. It would also be miserable to spend your later years having to cut back on the luxuries that you had got used to.

If you are able to answer a few of the "what if" questions ahead of events, then you'll be in a far better position to deal with things if the

"Should we live on
cornflakes and take
no holidays until
retirement?"

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“what ifs” actually come to pass. What if I get made redundant in my early fifties and can’t find another job? What if I decide to have more children and need to take career breaks? What if my investments don’t grow as quickly as I’d expected? How likely are these things to happen?

A good retirement plan takes into account these sorts of events, and their likelihood of occurring. So, at every stage of the planning process, you need to be thinking not only about what you expect (and/or hope) to happen, but how likely it is that things will work out differently and by how much. A good plan is also monitored and tweaked, as the “what ifs” turn into “whens” or “definitelys”.

In fact, many of us have pensions, through work or privately, but these are unlikely to provide the full answer to our retirement needs and some people will find that other forms of saving, like the ISAs we talk about in Step Eight, will serve them better. One thing is for sure: pensions are complicated beasts, so pop over to our [Pensions Centre](#) to get the Foolish lowdown.

In the meantime, there is another way to help provide for your retirement and it involves investing in the stock market yourself. This may seem a bit daunting but it truly isn’t, and it’s not that difficult to do. So be brave and move on to Step Five as we unveil all that is mysterious (Not!) about the stock market.

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Step Five - Getting Comfortable With the Stock Market

Right! Investing. What is it? And why is it so great?

It's clear from the tables in Step One that the Law of Compound Returns is indeed a Miracle. But in order to make the most of this miracle our money has to be invested in the right place. Where? If you look at the first table in Step One again, you're probably wondering how you too can be a Florence, Faith or even a Freda. You certainly don't want to be a Fenella, do you?

So where did Fenella go wrong? Well, she probably stuck her money in a building society like many of us do. With current rates of interest, and after tax, 5% is roughly the rate of return we might expect to get at the moment on our savings. It's not a lot, is it? Even so, she's very pleased with herself for taking such a responsible approach. Her Aunt Mavis would be proud of her. After all, the stock market is a dangerous place, full of sex and drugs and rock 'n' roll and people screaming "Buy!," "Sell!" into their mobile phones and jumping off tall buildings when it all goes wrong.

The reality is, though, that investing in shares doesn't have to be like this at all. Our other girls knew that and that's how they were able to get better long-term returns. We're much more interested in what the others did. To achieve those returns, they'd have had to invest in the

“All the evidence shows that over long periods, the stock market has produced returns that far outweigh those offered by a mere building society.”

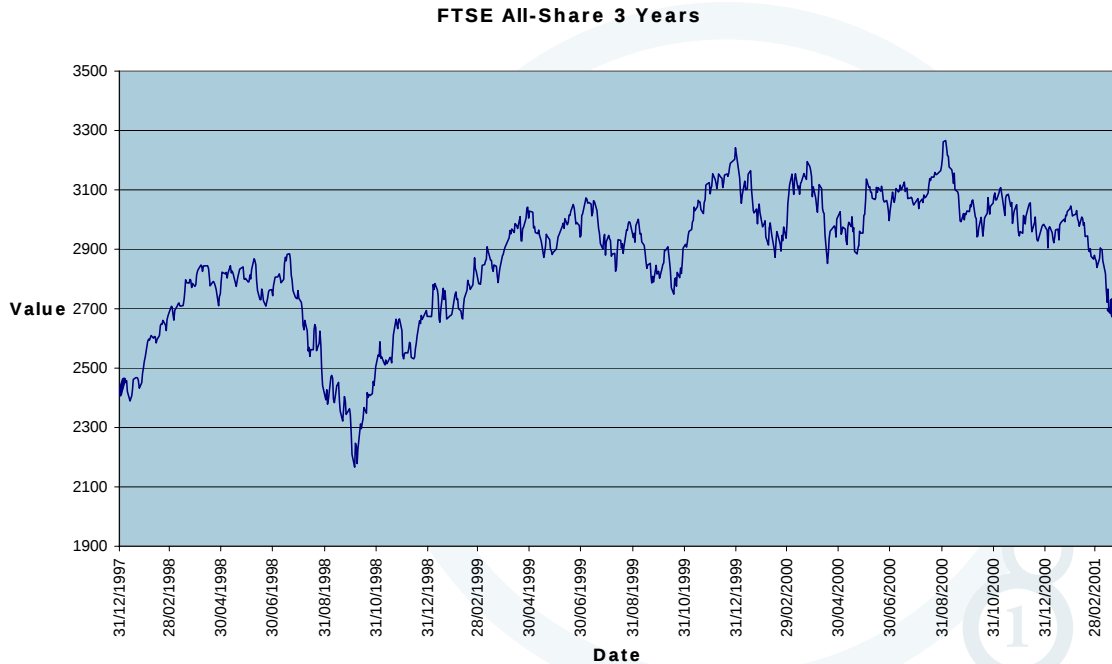
shares (or perhaps property). And they've done it with varying degrees of success. Felicity will be a bit disappointed, having done worse than the market's long-term average, and Freda will be happy to have just about hit that average. Faith and Florence, on the other hand, are entitled to feel delighted with their performance and should pat themselves on the back. Despite their range of success, though, they've all done better than Fenella. So who's been taking the responsible approach now?

All the evidence shows that over long periods, the stock market has produced returns that far outweigh those offered by a mere building society. The [CSFB Equity-Gilt Study](#) tells us that over the last 80 years or so, the London Stock Market has returned an average annual rate of 12.3% (about 8.2% after inflation is accounted for). It has far outperformed cash in a deposit account (which made 5.5% per year or 1.6% after inflation) or gilts (which are Government bonds and made 6.2% per year or 2.3% after inflation). For property, we don't have figures going back to 1918, but over the period 1973-2000, Number 18 Acacia Close, Dullingham, Boringshire, returned an average 8% annually, according to the Nationwide House Price Index. Not too bad, but not quite as good as shares.

But what about all those crashes? What about Black Monday? Or was it Black Wednesday? What about all those people in America in 1929 who lost everything when the market collapsed? And then there's the more recent “Internet bubble”.

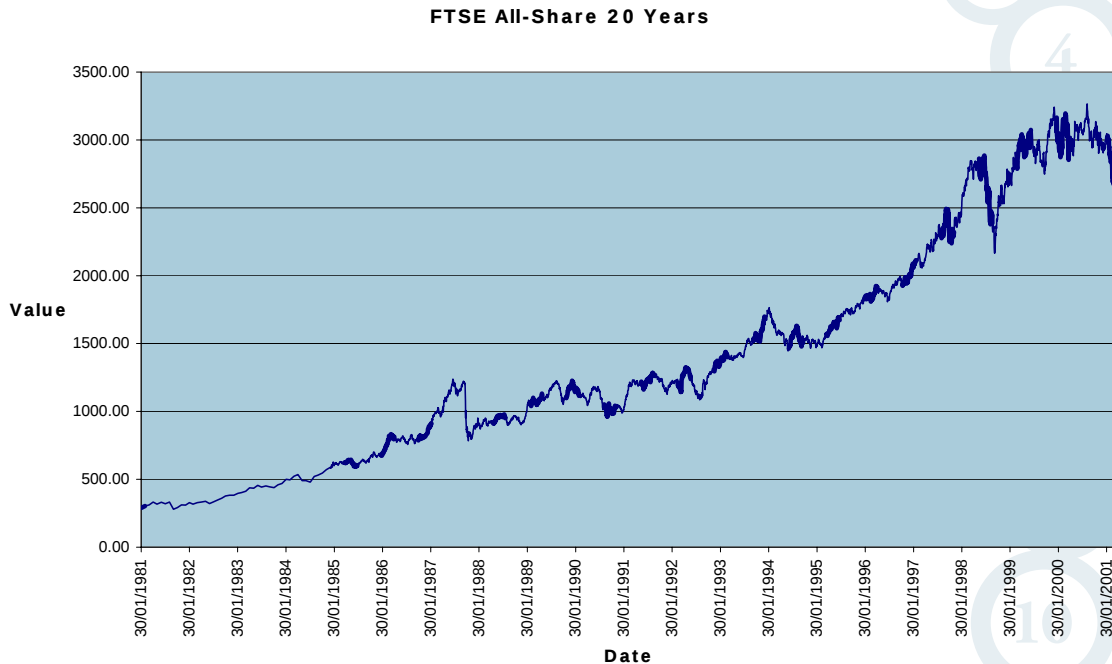
Never fear. When you look at graphs which track the movement of the UK stock market over short periods, the prospect of investing in the

stock market does indeed look frightening:



It all looks terribly serious doesn't it?

But look at the graph showing the growth of the stock market over a 20-year period and it's a different story. Can you spot the crashes?



Look carefully at the two graphs and note three things:

1. Note the upward direction of the 20-year graph.
2. Note that in the 20-year graph, that there have been similar 'crashes' at times but that the wobbles are small in comparison to the overall direction.
3. Note *once again* the overall direction of the 20-year graph.

We think that these simple graphs speak volumes. If the financial media and commentators, not to mention Fenella's Aunt Mavis, would pay more attention to what they show instead of focusing on the short-term wobbles which dominate the short-term agenda, then the world would be a much better place. And people would do even better out of our friend compound interest, too. Talk about not seeing the wood for the trees!

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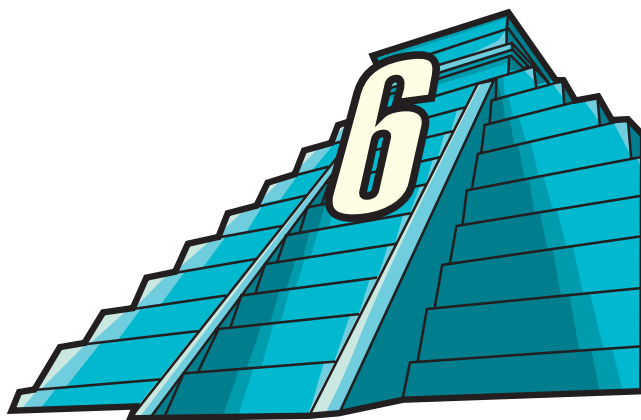
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Step Six - Investing Made Simple

Simple investing means buying an index tracker. Eh? What's an index tracker, you say? Well, an index tracker simply copies a stock market index so you can buy the overall market without having to do any work. Still not clear? Okay then, try this:

In order to get a general idea of how share prices were performing overall, market indices were invented at the end of the last century. These are groups of shares (i.e. companies) lumped together because they're considered to be representative of the market as a whole, or of a particular portion of it. Suffice to say an index illustrates how well or badly a particular stock market, or section of it, is doing.

On the London Stock Exchange there are a number of indices, the FTSE 100 and the FTSE All-Share being the two best known.

The FTSE 100 index is made up of the 100 largest companies in the UK. (In fact, when you hear that the "Footsie is up," the "Footsie is down" or "Shake it all around" on the TenO'clock News, this generally

**"Simple investing
means buying an
index tracker."**

refers to the FTSE 100).

It is a “weighted index”, which just means that the bigger companies make up proportionately more of it, and have a greater effect on its movements, than the smaller companies. So a fund that tracks that index (a “FTSE 100 Index Tracker”) will perform in line with the fortunes of the country’s 100 biggest companies. That should calm Aunt Mavis down a bit. Since the FTSE 100 was started in Jan 1984, it has provided a total return, before costs and including dividends, of a bit more than 15% per year.

The FTSE All-Share index comprises around 800 companies including all the ones in the FTSE 100. In fact the top 100 make up about 80% of the total value of the All-Share. So, it’s a bit more widely spread than the FTSE 100, but not by a large amount. Like the

FTSE 100, the All-Share is also a weighted index and, since it started in 1962, it has provided a total return, before costs and including dividends, of a bit less than 15% per year.

The most common type of index tracker is a ‘unit trust’. This is a fund in which you buy ‘units’ rather than buying shares; so if the index it is tracking rises, each unit is worth more, and if it falls, each unit is worth less. It’s obviously a good thing if the value of the units rises because the money you’ve already invested will be worth more. But it’s not necessarily a bad thing if their value falls over a short-term period because it means you can buy new units more cheaply. The posh people in the City like to call it a ‘buying opportunity’.

There are a number of unit trusts that follow the FTSE All-Share or the FTSE 100 as closely as they can, and these are known as index-tracking unit trusts. Different index trackers use different strategies to mimic the performance of the index, and the details are unimportant so



long as the index is tracked reasonably closely.

Mostly, there is no initial charge in index-tracking unit trusts (£100 paid in remains £100 -- a truly revolutionary idea for unit trusts), and annual charges vary from 0.4% to 1%. It is important to look in the promotional blurb to see how closely each index tracker has matched the index since it has been in existence, as there can be quite a difference in this “tracking error”.

“It is important to look in the promotional blurb to see how closely each index tracker has matched the index since it has been in existence, as there can be quite a difference in this ‘tracking error’.”

So, buying the market simply involves “buying” the index and tracking its fortunes through thick and thin. You can be confident that you will get close to the average and therefore be sure to avoid the worst performers. And, because they charge less, over time trackers perform better than the vast majority of actively managed funds, as we’ll explain in Step Seven. And all this comes with virtually no bother at all. Not bad, is it? It is, of course, vital to realise that your returns will not pile onto the value of your investment smoothly year on year. Some years (like 2000), there will actually be a loss, and other years a far greater gain (like 1999). This is how the stock market works and, in buying an index tracker, Foolish investors tie their fortunes intimately to the

short-term ups and downs of the market. But they also tie themselves intimately to the long-term up.

There are no guarantees either that the stock market will average previous annual growth rates in future. All we can say is that this is what it has done since 1918 and that, over the long term, shares have

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done better than cash or gilts (Government bonds, remember).

As with any stock market investment, think long-term – at least five years, and preferably ten. You think you might need this money in the next few years? Don't put it in an index tracker – in fact, don't put it anywhere near the stock market. However, if you want to invest it for your retirement, or to build up a pot to pay off your mortgage 25 years down the line, then it's hard to argue against an index tracker. For you, perhaps this type of investment will be the beginning and end of your investment career. You don't need to do anything else except sit back and watch your investment grow over the years until you get to the stage where you need it. You can read more about why index trackers [beat actively managed funds](#), [how they work](#) and [how to choose them](#) in the Fool's [ISA Centre](#).

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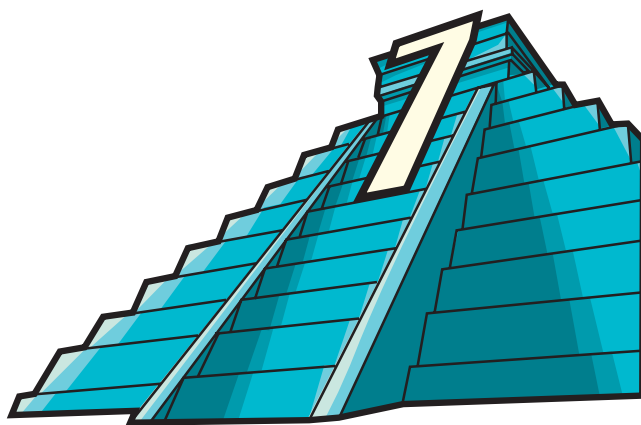
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Step Seven - An Alternative - Buy Your Own Shares

Many of us view the stock market as the province of professionals making and losing millions every day on the basis of sudden, earth-shattering decisions. Whatever we think of it, most of us don't see it as a place for mere mortals who lack nerves of steel and a first-class honours degree in economics.

The fact is, though, that the stock market has proven to be the most reliable long-term investment vehicle over the last eighty years, and that is true in the UK, the USA and across the rest of Europe. As we know from the [CSFB Equity-Gilt Study](#), since 1918 the London stock market has far outperformed cash in a deposit account or gilts.

Remember Florence from the table in Step One? The rich one? Well, Florence has been picking and choosing individual shares. For example, back in 1985 she noticed that Bollychip plc had come up with a tiny microchip that would do all the work of all the microchips currently installed in her washing-machine sized computer at work. So she did a bit of digging around, read the company's annual report, saw that it had been growing quietly and steadily for the last 10 years, and bought

some shares in the company. Then she sat on them. And sat, and sat...

She didn't spend every waking hour checking the share price or phoning her broker to finesse the short-term movements of the share price. She did, though, keep an eye on the company's long-term performance (as she did for each of the 10 or 12 shares in her portfolio). Every now and then, she would check to see that the company's performance was still on track, and she was pleased to see the tiny microchip being used in many new devices, causing Bollychip's profits and share price to grow rather nicely. Fifteen years later her initial capital investment of £1,000, having grown at 20% per year, had turned into more than £15,000.

Well done Florence. She's entitled to feel a bit smug! She spotted a potential money-spinning company, did her own research and took action. In fact, annual returns of 20% a year are fairly unusual for the private investor and few of us are that clever (or smug). Annual reports are full of figures that don't mean anything to those of us who don't know a net asset from a ball bearing and this is why it often makes sense to invest in a simple index tracker.

But you don't have to be as clever as Faith to do well out of investing in individual shares. So long as you don't do too much buying and selling, thereby keeping your costs as low as possible, and so long as you keep yourself spread broadly across the market, you should end up pretty close to the market average over the long term. If you can just find slightly better investments than the next man or woman, then you might even do a bit better. There is of course the chance to do a bit worse as well but that, in case we haven't mentioned it, is why index trackers were invented for those of us who don't fancy our chances.

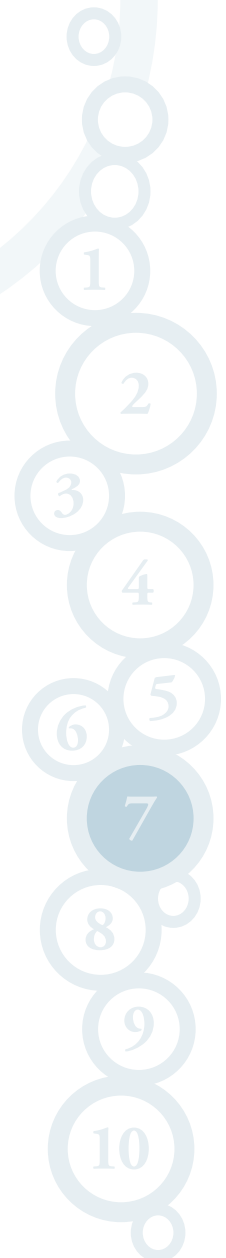
**“Wake up, Britain!
You're being taken
for a ride.”**

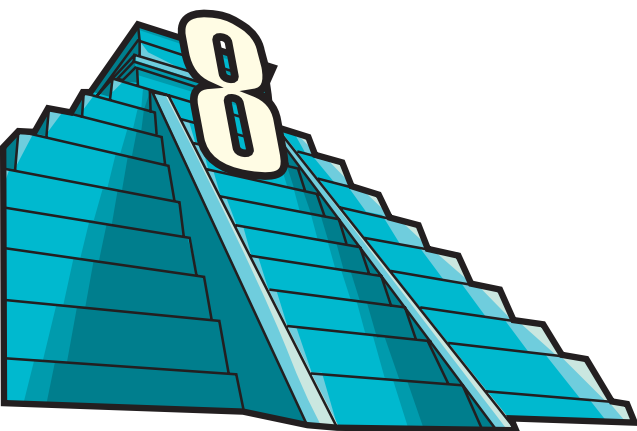
The alternative is to give our money to one of those slick chaps in the City with red braces and a Porsche. They're rich, so surely they know what they're doing. The trouble is, though, that the reason these chap-pies are generally so rich is that they charge us rather a lot for the pleasure of managing our money. And over long time periods more than 80% of

the funds they manage fail to beat a simple index tracker! (It's true! See [here](#)!)

Wake up, Britain! You're being taken for a ride. Not only are you investing in funds with below-average performance, but you are paying through the nose for the privilege. You could pay as much as 5% in initial charges every time you hand your money over, not to mention annual management fees of around 2%. What for? You don't have to do it this way! In fact, you're likely to do far better by buying into a simple index tracker or, if you're prepared to learn how to evaluate companies, by buying individual shares for yourself.

Be sure to keep your costs low, though! There's no point keeping your money away from the fund managers and then giving it to the stock brokers instead because you trade too often. The DIY approach involves more risk, of course, but you can learn how to do it [here](#) and you can get yourself a good cheap broker [here](#). Take things slowly. Learn about it first. Perhaps set up a dummy portfolio so you can track your fortunes without risking any real money while you learn. Remember, only fools (with a *small* "f"!) rush in, and you're not one of those, are you?





Step Eight - Protecting Your Money From Tax

There are several ways of protecting your money from tax but the simplest way is to make sure your savings and investments are held inside an ISA. For other methods take a look at our [Tax Centre](#) but for Step Eight

“ISA stands for
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let's just concentrate on the ISA. ISA stands for Individual Savings Account and here at the Motley Fool we like them a lot.

An ISA is like a tax-proof cling film. Wrap it tightly around your investments and the taxman cannot get to them any more than bacteria can land on your maturing slice of Camembert. The wrapper does not change the contents, merely the effect the outside world can have on it. If the contents are good, like a nice slice of Camembert, they stay good. If the contents are bad, like four-day old fish pie, then they stay that way. An ISA is not an investment in its own right but, like cling film, you can look right through and see what is inside.

We think the ISA is a good thing. Putting an ISA around your investments prevents the taxman charging you any capital gains tax or any extra taxes on dividends. What is bad for the taxman is good for you. It means you get to keep more of your own hard-earned money. Great, isn't

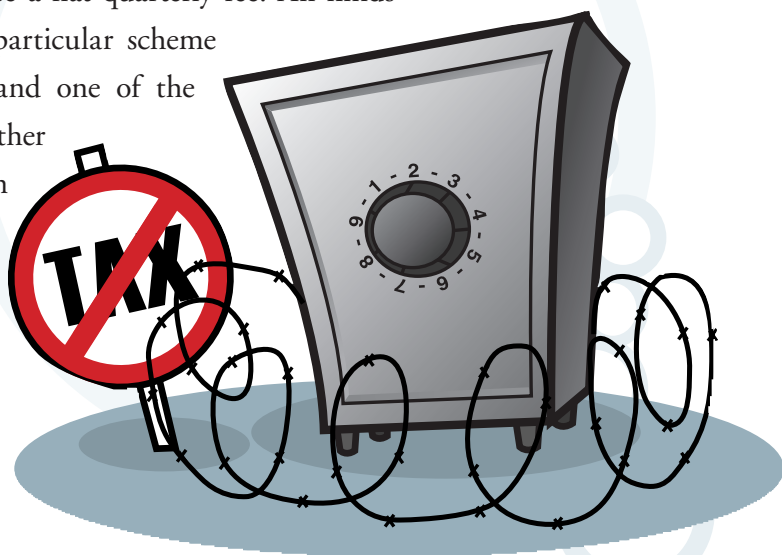
it? In fact it is not unreasonable, because the money you are investing has already been taxed once. It has come from your net income. To tax it twice would be a little harsh, to say the least.

However, Fools will not be surprised to learn that different ISA managers have widely differing charges for the same product. In general, these are either based on a charge for each dividend tax credit collected by the ISA manager, or else a flat quarterly fee. All kinds of considerations dictate which particular scheme will be most efficient for you, and one of the most important of these is whether ISAs from different tax years can be “bundled” together into one mega-ISA. In these cases, flat fees start to look very attractive indeed.

The other major consideration is brokerage charges, since you can only buy and sell shares within a self-select ISA via the ISA plan manager. Dealing fees are not yet as low as in the USA, but they have come down significantly in recent years. If you shop around you'll find some that aren't far off the rates our American cousins enjoy.

For most people a simple index-tracking ISA will probably be the preferred course of action for a regular long-term savings plan. One of the nice things about these is that, once you've paid for the tracker, the manager will generally chuck the ISA wrapper in for free.

Apart from pensions, ISAs are the only tax breaks an investor gets these days, so they are well worth researching and using although you're restricted to investing a maximum of £7,000. The ISA comes in two flavours – the Mini and the Maxi – and you can invest a combination of cash, stock market investments and life insurance in various proportions. You can find out how they work and what sort of things you can put in them at the ISA Centre, [here](#).



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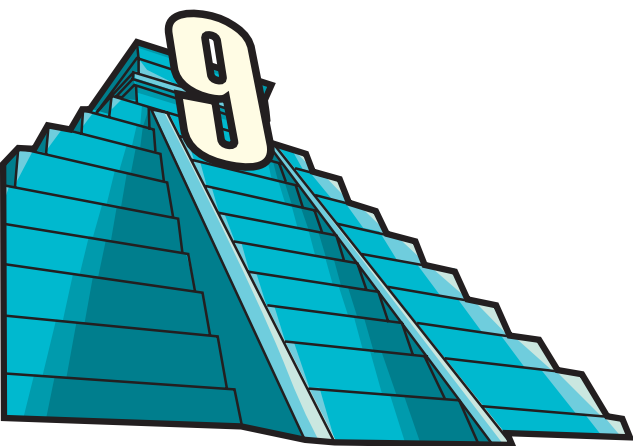
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Step Nine - Ah – Children

At the top of most people's lists of why they save and invest is probably to provide for the time when they will stop working. Also near the top would be to help their children lead better lives. Your money can do a lot for your children. It can provide a secure home, pay for their education, holidays, books, a computer, and much, much more.

Let's say you decide to buy an index tracker for your new baby and can afford to invest £50 a month. With an average return of just over 12% on the stock market, you'll have accumulated £38,271 by the time she's 18. Hurrah – she'll now have the opportunity to fritter it away in a university student bar without accumulating debts! Alternatively, keep paying into that index tracker until she's 25 and, even bigger Hurrahs – she'll have £94,881 to spend on a deposit for a house. Inflation will obviously have some effect on value of these figures, but you take the point!

Giving money to children is great. But we believe that it is also important to teach your children the value of money, and to get them to start making their own investments as early as possible. You may not have 70 or 80 years ahead of you to watch your savings build up those compound returns that are so vital to Foolish investors, but a child who's under ten can probably expect to have over 70 years of investing life ahead of them.

If you were to invest £500 for 70 years, and you achieved the histori-

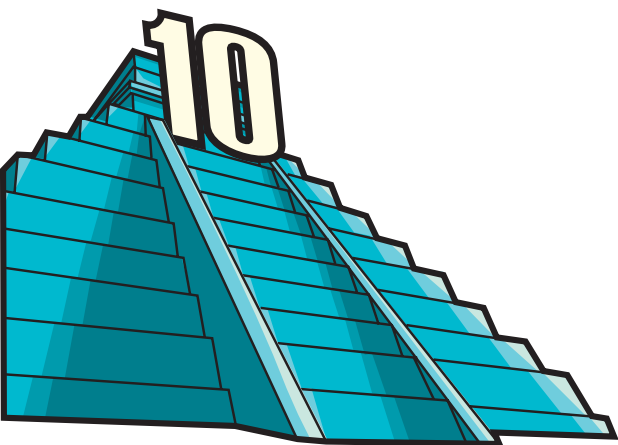
cal average market return of 12%, it would become £1,394,000 by the time your ten-year-old child becomes 80. OK, it is not realistic to invest £500 today, and never expect to touch it for 70 years; what would be the point of that? Money is to be invested to give you a better life: if you never spend it, how much better would your life actually be? So it's a question of striking a balance.

One of the most important things that you can teach your children is not to waste their money on the national lottery, scratch cards, or other highly improbable get-rich-quick schemes. And that means leading by example, too! Teach them not to run up credit card debt, especially during those vital first few years away from home when they are at university or starting their first job. Teach them the risk of taking out a big loan to buy a car that will only depreciate in value, and which they may well still be paying for long after the car has been consigned to the great scrapyard in the sky.

The easiest way to teach your children about finance is to get them involved. Teach them the miracle of compound growth. Teach them how money foolishly will grow, and how, when the growth is added in, that will also start to grow. Children are amazing in their capacity to absorb and learn.

Teach them to save money. Open a building society account for them, and get them to pay the money in themselves; instil in them the importance of saving. Introduce the idea of buying shares in companies, especially in ones that they will have heard of: your child who is Manchester United mad is going to become as interested in the financial performance of the company as the football results if he has a stake in the business. Investing for children should be fun, and they should be involved in making the decisions. A good place to start is [here](#).

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“The easiest way to
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Step Ten - Insure Yourself the Right Way

There are few financial topics more important (and, unfortunately, more mundane) than insurance. No matter how diligently you build your financial empire, failure to purchase adequate insurance can put you in a desperate hole before you can say “heart attack”. On the other side of the coin, few things will attack your investment returns more insidiously than paying too much for insurance or, worse, paying for insurance you don’t need.

So, you may be thinking now, “I don’t *need* insurance.” To that we say: actually, you probably do. If you own things that will be very hard to replace without facing severe financial hardship, these things ought to be insured. In general, think of insurance as “hardship avoidance”.

If you have a car, then insurance is required by law. But what about your health? Could you afford to lose it? If you become sick or disabled, temporarily or permanently, would you be able to support yourself? For most people, the answer is “no,” yet a large number of people are not insured for disability.

How about your life? If you were to die suddenly, what kind of financial hardship would result? Would there be dependants left without basic support? Morbid as they are, these questions are at the root of life insurance decisions. If there are people who can’t afford to lose you, you can’t

afford to be without life insurance.

Remember, though, that every pound you spend on insurance is a pound that you haven't saved. Ultimately, your aim is to get a pile of savings together which is big enough that your family could carry on happily in the event of your death, even without life insurance. It's in the meantime, before you've saved up enough, that you need things like life insurance. So bear in mind that, the more cover you buy, the longer it will take for you to get to a point where you no longer need to buy it. It's a tricky balance to find, so pop along to the [Fool's Insurance Centre](#) to find out about it.

Another form of insurance you'll need if you're a homeowner is to protect your house. In addition, you'll need contents insurance if you have belongings you couldn't afford to replace.



Whatever you do, don't lose your insurance cover by missing payments. Since insurance has little impact on daily life, it's easy to overlook these payments. If you really need the insurance, these premiums should come second only to food and shelter in your list of priorities, and certainly ahead of investing.

Fun or no fun, insurance is one finance topic that you don't want to overlook. Contrary to some common perceptions, insurance is not a rip-off. For most people, it is a necessary and valuable financial service. As always, you just need to make sure you get the best deal for what you want.

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And Finally...

Congratulations! You're nearly there.

Think about your goals. They do not have to be set in stone, or even crushingly realistic. As long as they spur you to long-term saving and investing without destroying your standard of living or leaving you without a float for emergencies, that is good enough. After all, we all have to dream, right?

With your goals set (mmm, yes, a 60-foot schooner, canvas taut with the South-East trades, the lofty, cloud-fringed peaks of a South Pacific isle appearing over the... DOIINNNG! Back to reality!), figure out what kind of regular investment you will need to make to achieve them, reckoning on the average long-term performance of the investment strategy you are going to choose.

“Don't rush into
anything. Stop,
think, rehearse.”

Don't bankrupt yourself with unrealistic targets for each month's savings. Think in the order of 10% of your net income and work up or down from there, depending on your income, outgoings, enthusiasm, need for regular meals, flow of consumer durables, foreign holidays, fine wines, and so on.

Get your financial house in order, learn the basics of Foolish investing, think about which goals are important to you – and then read up on them at our Decision Centres, below. Learn as much as you can, ask questions on our boards and only when you really feel you're ready, dip a toe in the water. Don't

rush into anything. Stop, think, rehearse.

Finally, don't get obsessed. Lie back, relax, spend more time with the kids, your spouse, your partner, your dog, your football team. Go travelling, read a good book, take up the piano, pigeon-racing or whatever. There's more to life, far more, than simply investing.

The Motley Fool's Decision Centres

- [Get out of Debt](#)
 - [Online Banking](#)
 - [Brokers](#)
 - [ISAs](#)
 - [Taxes](#)
 - [Homeowning](#)
 - [Investing for Children](#)
 - [Insurance](#)
 - [Pensions](#)
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